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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. MC2013-57

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. CP2013-75

UNITED STATES POSTAL SERVICE REPLY COMMENTS
SUBMITTED PURSUANT TO ORDER NO. 2011
(April 4, 2014)

Pursuant to Order No. 2011¹, the United States Postal Service (the “Postal Service”) files its reply comments addressing the comments submitted pursuant to Order No. 2011 by the Public Representative, GameFly, Inc. (“GameFly”), and Netflix, Inc. (“Netflix”).² Order No. 2011, and the comments cited above, addressed the responses to Chairman’s Information Request (“ChIR”) Nos. 1, 2, and 3.³ These reply comments address parties’ comments regarding competition, the relevant market, the importance of data concerning elasticities, and application of the Private Express Statutes.

¹ Order No. 2011, Order Establishing Comment Dates, PRC Docket Nos. MC2013-57 & CP2013-75 (March 7, 2013).

² Comments of the Public Representative in Response to Order No. 2011 (hereinafter “PR Comments”), PRC Docket Nos. MC2013-57 and CP2013-75 (Mar. 21, 2014); Comments of Netflix, Inc. Submitted Pursuant to Order No. 2011 (hereinafter “Netflix Comments”), PRC Docket Nos. MC2013-57 & CP2013-75 (March 21, 2014); Comments of GameFly, Inc., on Responses of USPS and Netflix to Chairman’s Information Requests (hereinafter “GameFly Comments”), PRC Docket Nos. MC2013-57 & CP2013-75 (Mar. 21, 2014).

³ Chairman’s Information Request No. 1 (hereinafter “ChIR No. 1”), PRC Docket Nos. MC2013-57 & CP2013-75 (Dec. 18, 2013); Chairman’s Information Request No. 2 (hereinafter “ChIR No. 2”), PRC Docket Nos. MC2013-57 & CP2013-75 (Dec. 18, 2013); Chairman’s Information Request No. 3 (hereinafter “ChIR No. 3”), PRC Docket Nos. MC2013-57 & CP2013-75 (Dec. 18, 2013).

I. COMMISSION PRECEDENT SUPPORTS CLASSIFICATION OF THE ROUND-TRIP MAILER AS A COMPETITIVE PRODUCT.

In its comments responding to the answers of Netflix and the Postal Service to Chairman's Information Request Nos. 1 and 3, GameFly claims that the Postal Service's request to create a competitive Round-Trip Mailer product is fatally flawed for two reasons.⁴ First, GameFly claims that because some customers still prefer to receive DVDs by mail, and that the Postal Service represents the only practical means for serving those customers, the Round-Trip Mailer product must remain market dominant despite the existence of competitive alternatives in the market it serves (the delivery of digitized entertainment content).⁵ Second, GameFly claims that the lack of specific elasticities for Round-Trip DVD mail means that the Postal Service cannot show that the advent of competitive alternatives has resulted in pricing pressures sufficient to deter it from raising DVD prices.⁶ These arguments conflict with Postal Regulatory Commission ("Commission") precedent, which supports the Postal Service's request for classification of the Round-Trip Mailer as a competitive product.

A. Customers' Decisions to Rely on a Postal Product, Despite the Existence of Competitive Alternatives, does not Preclude the Commission from Classifying that Product as Competitive.

In determining whether to approve the transfer of a postal product to the competitive product list, the Commission must consider whether

the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices

⁴ See Comments of GameFly, Inc., on Responses of USPS and Netflix to Chairman's Information Requests (hereinafter "GameFly Comments"), PRC Docket Nos. MC2013-57 & CP2013-75 (Mar. 21, 2014).

⁵ *Id.* at 2.

⁶ *Id.* at 2-3.

significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products.

39 U.S.C. 3642(b)(1). If the product meets this test, the product is categorized as market dominant. If it does not (and if it is not subject to the Private Express Statutes), the product is categorized as competitive.⁷

As mentioned above, GameFly contends that because some customers in the market for delivering digitized entertainment content prefer to receive DVDs by mail, the Commission must find that Round-Trip DVD mail satisfies the test for determining market dominance under Section 3642(b)(1).⁸ In other words, so long as some group of customers within a delivery market choose to rely, or are reliant, on a postal product (regardless of the existence of competitive alternatives), that postal product must always be classified as market dominant. While such an interpretation of Section 3642(b)(1) is undoubtedly appealing to GameFly, it conflicts with the plain language of the statute and would have essentially precluded most of the major transfers approved by the Commission in recent years. In such cases, the Commission has soundly rejected GameFly's position and wisely taken a more comprehensive and common-sense approach to evaluating postal products' dominance in a marketplace.

For example, in Order No. 710, the Commission approved the transfer of First-Class Mail Commercial Parcels to the competitive product list.⁹ In that case, the Postal

⁷ In addition to satisfying the requirement of Section 3642(b)(1), the Commission must also evaluate additional considerations under 39 U.S.C. § 3642(b)(3). These considerations include the availability and nature of enterprises in the private sector engaged in the delivery of the product involved, the view of those who use the products involved on the appropriateness of the proposed action, and the likely impact of the proposed action on small business concerns.

⁸ GameFly Comments at 2.

⁹ See Order No. 710, Order Adding Lightweight Commercial Parcels to the Competitive Product List, PRC Docket No. MC2011-22 (Apr. 6, 2011), at 11.

Service proposed transferring the commercial segment of First-Class Mail parcels to the competitive product list, which consisted of lightweight fulfillment parcels less than one pound (“Lightweight Fulfillment Parcels”).¹⁰ The Postal Service described the market for Lightweight Fulfillment Parcels as being segmented into three categories: (1) 2-to-3-day air, (2) consolidator ground, and (3) commercial carrier ground.¹¹ Although the Postal Service acknowledged that it had captured a majority of the market share in the 2-to-3-day air category,¹² it also presented evidence showing that competitors such as FedEx and UPS were gaining market share in the Lightweight Fulfillment Parcel market through their consolidator ground offerings.¹³

Faced with facts similar to those alleged by GameFly in this proceeding – that is, Postal Service dominance in a subcategory of a larger competitive delivery market – the Commission ultimately approved the transfer of Lightweight Commercial Parcels to the competitive product list. The Commission noted that it had “taken into account the Postal Service’s dominance in the 2-to-3-day air segment of this market” but that the market share data presented by the Postal Service indicated “the presence of significant competition in the marketplace.”¹⁴ Had the Commission applied GameFly’s more rigid interpretation of Section 3642(b)(1), the Commission would have denied this transfer because of the Postal Service’s dominance in 2-to-3-day air subcategory. Instead, the Commission appropriately chose to evaluate the Postal Service’s market position for

¹⁰ *Id.* at 2-4.

¹¹ Request of the United States Postal Service Under Section 3642, PRC Docket No. MC2011-22 (Feb. 24, 2011), Att. B at 4.

¹² *Id.* at 4-5.

¹³ *Id.* at 4-6.

¹⁴ Order No. 710 at 6.

Lightweight Fulfillment Parcels by taking into consideration the Postal Service's lack of market power in the larger fulfillment parcels market.

The Commission also applied this total-market approach to evaluating a product's market dominance in Order No. 689.¹⁵ In that order, the Commission approved the transfer to the competitive product list of Commercial Standard Mail Parcels (now known as Lightweight Commercial Parcels), which consisted of bulk commercial parcels weighing less than one pound.¹⁶ During that case the Postal Service again acknowledged that it had captured a majority of the market share in the bulk segment of the under-one-pound commercial parcel market,¹⁷ but advanced three arguments in support of the transfer: (1) that its market share was distorted by below-cost pricing;¹⁸ (2) that when viewed in the context of the larger ground parcel market the Postal Service only had a 20.1 percent market share;¹⁹ and (3) that a substantial price increase (required to cover attributable costs under 39 U.S.C. § 3633) would create a substantial risk of losing a significant level of business.²⁰ Thus, despite Lightweight Commercial Parcels' large share of a limited market segment, the Postal Service contended that the product did not meet the test for market dominance under Section 3642(b)(1).²¹

¹⁵ Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, PRC Docket No. MC2010-36 (Mar. 2, 2011).

¹⁶ *Id.* at 20.

¹⁷ Response of the United States Postal Service to Commission Information Questions 1-2, 5-11 of Commission Request No. 1, PRC Docket No. MC2010-36 (Dec. 15, 2010), Att. A at 4-5.

¹⁸ *Id.* at 5-6.

¹⁹ *Id.* at 6-7.

²⁰ *Id.*

²¹ *Id.*

In opposing that transfer, the Parcel Shippers Association (“PSA”) presented arguments similar to those raised by GameFly. In particular, PSA argued that, because the Postal Service had captured nearly 80 percent of the lightweight commercial parcel market segment, it had *de facto* power to raise prices substantially without the loss of a significant volume of business to other firms.²² In addition, PSA questioned whether the data presented by the Postal Service was sufficient to prove that the Postal Service would in fact lose a substantial volume of business if prices were raised or service were degraded.²³ As with GameFly’s arguments in this case, PSA’s arguments took a narrow view of how Section 3642(b)(1) should be applied, ignoring the role of the postal product in question in the larger marketplace.

In approving the transfer of Lightweight Commercial Parcels to the competitive product list, the Commission clearly rejected the arguments advanced by PSA. Indeed, the Commission approved the transfer, notwithstanding the Postal Service’s significant market share, and stated that

[a]ny pricing power the Postal Service may enjoy is illusory based on its pricing under one-pound parcels below cost. In any event, the Postal Service’s ability to raise rates is limited by the competitors’ decisions on pricing. The Postal Service has amply demonstrated there is at least a risk of losing a substantial amount of business if its rates are raised significantly or if it alters its service.

Order No. 689 at 16. The Commission also took into account the impact of the transfer on outlying delivery areas that might be more reliant on Lightweight Commercial

²² Parcel Shippers Association Comments on the United States Postal Service Request to Transfer Commercial Standard Mail Fulfillment Parcels to the Competitive Product List, PRC Docket No. MC2010-36 (Sept. 24, 2010), at 6.

²³ *Id.* at 8-9.

parcels.²⁴ In that regard, the Commission noted that “[t]he Universal Service Obligation (USO) covers all mail matter, not just market dominant products” and stated that it was

confident that while the Postal Service may establish higher prices for competitive lightweight parcels in the absence of the price cap constraint, competitive market forces will ensure that readily available small parcel delivery service to all areas will remain.

Order No 689 at 18. Again, the Commission’s approval of the transfer was predicated upon a more rational approach to transfers than the narrow one that GameFly advances in this case. The Commission recognized that any market dominance analysis under 3642(b)(1) must take into account a broad array of factors, not just whether a small subset of customers in a marketplace happens to rely on a postal product.

In short, past Commission precedent in product transfers disfavors the proposition that Section 3642(b)(1) requires the Postal Service to show that “all customers” view competitive alternatives to a postal product as being “good substitutes” to the postal service provided.²⁵ Such an exacting standard does not exist in the plain language of Section 3642(b)(1), and would have the practical effect of barring nearly all product transfers, so long as some group continues to prefer or rely on a particular postal service. The Commission should continue to use a more comprehensive approach when determining the market dominance of Round-Trip DVD mail, taking into consideration the product’s role in the broader delivery market for digitized entertainment content.

²⁴ It is noteworthy that GameFly and the Public Representative oppose the creation of a competitive Round-Trip DVD product due to the limited availability of competitive alternatives in outlying delivery areas. See, e.g., Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, Docket Nos. C2009-1(R), MC2013-57, and CP2013-75 (Aug. 15, 2013) at 15-16; PR Comments at 4-5.

²⁵ GameFly Comments at 9-10.

B. Competitive Product Status Is Not Conditional on the Development of Elasticity Data.

As mentioned above, the second pillar of GameFly's argument is that the Postal Service must provide specific elasticities for Round-Trip DVD mail in order to show that the advent of competitive alternatives has resulted in pricing pressures sufficient to deter it from raising DVD prices.²⁶ While the Commission has recently acknowledged the Postal Service's work on developing product-specific elasticities in the FY13 Annual Compliance Determination Report ("FY13 ACD"),²⁷ the Commission has never required that elasticities be provided as a prerequisite to classifying a product as competitive.

For example, the Commission approved the transfer of Lightweight Commercial Parcels in Order No. 689, despite the fact that the Postal Service could not "estimate the volume or revenue impacts because it has no demand elasticity estimate for commercial Standard Mail Parcels."²⁸ The Commission has also approved the transfer of Parcel Post,²⁹ First-Class Mail Commercial Parcels,³⁰ and Competitive P.O. Box Service³¹ to the competitive product list without the provision of product-specific elasticities.

²⁶ In support of this argument, GameFly cites to several portions of a recent Office of Inspector General ("OIG") report on postal elasticities. See GameFly Comments at 3-4. Using this report, GameFly concludes that postal elasticities are inelastic, which suggests that no competition exists for Round-Trip DVD Mail. However, that same OIG report also acknowledges that the elasticities studied apply "to an aggregate classification of mail" and that "[i]t may be the case that market segments within an aggregate classification examined in this report are price elastic." USPS OIG Report No. RARC-WP-13-008, Analysis of Postal Price Elasticities, at 7 (May 1, 2013).

²⁷ FY13 ACD, PRC Docket No. ACR2013 (Mar. 29, 2014), at 54.

²⁸ Order No. 689 at 15.

²⁹ See *generally* Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, PRC Docket No. MC2012-13 (July 19, 2012).

³⁰ See *generally* Order No. 710.

³¹ See *generally* Order No. 473, Order Approving Request to Transfer Selected Post Office Box Service Locations to the Competitive Product List, PRC Docket No. MC2010-20 (June 17, 2010).

Additionally, implicit in GameFly's elasticity argument is the notion that, to satisfy the market dominance test under Section 3642(b)(1), the Postal Service must show conclusively that it will lose substantial business as a result of price increases or degradation of service. However, the Commission clearly rebutted this notion when it noted that the law

does not require a certainty that business will be lost if prices are raised either significantly or significantly above costs. Rather, section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market dominant.

Order No. 689 at 14-15. The Postal Service has established that price increases to the Round-Trip Mailer product will enable competitive alternatives in the digitized entertainment market to capture the Postal Service's Round-Trip DVD business.

Contrary to GameFly's complaint about the lack of product-specific elasticities, Commission precedent does not establish such elasticities as a prerequisite to competitive classification. The Commission should rationally follow its precedents by evaluating the entire record of evidence when determining whether Round-Trip DVD mail faces price competition from alternatives in the delivery market for digitized entertainment.

II. CONSUMERS FREELY SUBSTITUTE BETWEEN MAIL, KIOSK, STREAMING, DOWNLOADING, AND OTHER METHODS OF OBTAINING ACCESS TO DIGITIZED ENTERTAINMENT CONTENT.

The Postal Service's earlier comments in this proceeding included a detailed description of the numerous methods of providing consumer access to digitized

entertainment content, and the increased use of these methods by consumers.³²

Despite GameFly's challenges to the effectiveness of these methods,³³ the Postal Service renews its position that kiosk, streaming, downloading, and other methods of providing access to digitized entertainment content compete effectively with mail delivery of this content, and will constrain the price of the Round-Trip Mailer product.

In its comments, the Public Representative's fixation on elasticities³⁴ suggests a view that changes in the cost of providing consumer access to digitized entertainment content through the mail have not led to changes in the volume of DVDs delivered through the mail, and thus other methods of providing consumer access to digitized entertainment content do not constrain the price of mail delivery. The information provided in this proceeding does not support that contention, however.

First, from the mailer's perspective, Netflix's development of its streaming service demonstrates the substitutability of mail and digital methods of providing consumer access to digitized entertainment content. After the Postal Service announced two separate two-cent increases in First Class Mail postage to take effect in 2006 and 2007,³⁵ Netflix began to offer consumers access to digitized entertainment content

³² United States Postal Service Comments Addressing Responses to Chairman's Information Request Nos. 1, 2, and 3 (hereinafter "Postal Service ChIR Comments"), PRC Docket Nos. MC2013-57 & CP2013-75 (Mar. 21, 2014); United States Postal Service Update to Response to Comments, PRC Docket Nos. C2009-1(R), MC2013-57, & CP2013-75 (January 22, 2014); Response of the United States Postal Service to Chairman's Information Request No. 1, PRC Docket Nos. MC2013-57 & CP2013-75 (Jan. 17, 2014); United States Postal Service Response to Comments, PRC Docket Nos. MC2013-57 and CP2013-75 (Sept. 23, 2013); United States Postal Service Reply to Comments, PRC Docket Nos. MC2013-57 and CP2013-75 (Aug. 22, 2013).

³³ See, e.g., GameFly Comments at 2.

³⁴ PR Comments at 2-3.

³⁵ United States Postal Service, Rates for Domestic Letters Since 1863, <http://about.usps.com/who-we-are/postal-history/domestic-letter-rates-since-1863.pdf> (last visited Apr. 2, 2014).

through streaming as an alternative to mail delivery.³⁶ In 2011, Netflix DVD mail volume declined for the first time, and it has continued to decline every year after 2011.³⁷ The evolution of Netflix's business and the change in its mail volume demonstrate how a Round-Trip Mailer can reduce volume in response to a price increase, and conflict with the Public Representative's characterization of the Postal Service's pricing power.

From the perspective of the consumer of digitized entertainment content, the consistent decline in mail volume, increase in kiosk volume, and more frequent use of streaming and downloading reflects the substitutability of these various access methods. In addition to the reduction in Netflix mail volume described above,

[REDACTED]

.³⁸ Information **[REDACTED]** suggests that price considerations influence consumer decisions regarding whether to access digitized entertainment content through mail delivery.³⁹ A consumer decision to shift away from mail access to digitized entertainment content could reflect an actual price increase of a GameFly or Netflix subscription, or a relative price increase of these subscriptions as compared to the cost of other methods of obtaining access to digitized entertainment content. Unless these consumers stop accessing digitized entertainment content altogether, however, their decision to terminate a DVD mail subscription reflects a shift to another form of obtaining access to digitized entertainment content in response to price considerations.

³⁶ Response of Netflix Inc. to Chairman's Information Request No. 3 (hereinafter "Netflix Response to ChIR No. 3"), PRC Docket No. MC2013-57 (Jan. 16, 2014), at 3.

³⁷ **[REDACTED]**

³⁸ USPS-LR-MC2013-57/NP7. Note that the Postal Service's fiscal year covers October 1 to September 30.

³⁹ Supplemental Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, PRC Docket Nos. MC2013-57 & CP2013-75 (Sept. 12, 2013) at 48.

Accordingly, this behavior indicates that the likely recipients of DVDs through the Round-Trip Mailer product will consider other methods of accessing digitized entertainment content and will compare the prices of these methods, which will constrain the price of the Round-Trip Mailer product.

GameFly's Chief Executive Officer, David Hodess, perfectly describes the flaw in GameFly's argument, in that "the only economically viable means of delivery between DVD rental companies and consumers is the Postal Service."⁴⁰ The scope of this statement is so narrowly tailored that the market includes only GameFly and the DVD mail delivery segment of Netflix, whose primary business has now shifted to a model of digital distribution.⁴¹ Thus, only *one* of the *two* companies in the *entire* market as described by Mr. Hodess is limited to exclusively using the Postal Service to reach its consumers.

The statement ignores all of GameFly's competitors who distribute entertainment through other channels.

[REDACTED]

Incredibly, however, Mr. Hodess would appear not to consider Redbox a "DVD rental company" – despite the simple fact that it is a company that rents DVDs – because Redbox's economically viable model does not rely on the Postal Service. The declaration also avoids mentioning that GameFly has pursued the establishment of its

⁴⁰ Declaration of David Hodess, PRC Docket Nos. MC2013-57 & CP2013-75 (Mar. 24, 2014) ("Hodess Declaration"), at ¶ 4.

⁴¹ Netflix, Inc., Form 10-K for the Fiscal Year Ended December 31, 2013 (hereinafter "Netflix 10-K") (2013), at 1. This and other 10-Ks referenced herein are available at <http://www.sec.gov/edgar.shtm>.

own system of rental kiosks,⁴² showing that the company does recognize the value of Redbox's distribution method. Mr. Hodess's declaration completely avoids discussing Redbox's success and focuses instead on digital gaming.

Previously, the Postal Service has cited to a number of public statements from other companies in the entertainment industry that described an interconnected web of competition between both digital games creators and distributors and physical providers.⁴³ The Hodess declaration attempts to dismiss the many viable digital game distributors, like Steam or Sony, by describing a litany of supposed issues associated with digital distribution of games. Mr. Hodess's declaration omits the many advantages of the digital distribution channel, which the Postal Service feels have been adequately described throughout this proceeding.

[REDACTED]

Yet Mr. Hodess's logic would appear to dismiss his own company's digital distribution channel based solely on its supposed disadvantages and without regard to its many advantages. GameFly's inability to adapt quickly to changing conditions and compete in these alternative channels does not mean that the rest of the market is similarly limited.

Finally, the declaration is of limited value to this case because it attempts to describe the market as unchanging, despite the fact that technology and delivery

⁴² Answers of GameFly, Inc., to Chairman's Information Request No. 2, PRC Docket Nos. MC2013-57 & CP2013-75 (Jan. 17, 2014).

⁴³ Postal Service ChIR Comments at 2-5.

methods are rapidly shifting.⁴⁴ The obstacles cited by Mr. Hodess are simply technological hurdles that are rapidly being overcome. Although now only competitors to physical distribution channels, these distribution channels will likely become increasingly dominant as hardware and internet infrastructure improves. The Postal Service should not be bound to an inflexible price for DVD mail, subsidizing GameFly's business model.

Although GameFly questions the effectiveness of competitors that provide consumer access to video game content through streaming or downloading, its most recent comments do not challenge the feasibility of providing access to video game content through kiosks. As described in the 2013 Outerwall 10-K and in earlier pleadings submitted by the Postal Service, RedBox's volume has grown from approximately 686 million rentals in 2011, to approximately 740 million rentals in 2012, to approximately 776 million rentals in 2013.⁴⁵ In 2012, Redbox rented approximately 15 million video games,⁴⁶ compared to GameFly's volume of [REDACTED],⁴⁷ which measures both the outgoing and return trips, and approximately 725 million video

⁴⁴ As evidence of the changing technology in this sector, there are continual developments in how entertainment content is delivered. Last week, virtual reality development company Oculus VR was purchased by Facebook in the hopes of creating a virtual social environment. Jason Henry, *Facebook in \$2 Billion Deal for Virtual Reality Company*, N.Y. TIMES (Mar. 25, 2014) <http://www.nytimes.com/2014/03/26/technology/facebook-to-buy-oculus-vr-maker-of-virtual-reality-headset.html>. Still more recently, Amazon announced its own set-top device "that lets consumers watch Amazon's extensive video library as well as play a wide array of games on their television sets." David Streitfeld, *With Fire TV, Amazon Seeks a Beachhead in the Living Room*, New York Times (April 2, 2014), <http://www.nytimes.com/2014/04/03/technology/amazon-firetv-set-top-box.html>. The article notes that this is a component of Amazon's shift toward producing digital content because "[p]hysical formats such as books, CDs and DVDs are disappearing, replaced by downloads and streaming." *Id.*

⁴⁵ Outerwall 10-K at 26.

⁴⁶ See *id.* at 26-27. This value represents two percent of the Redbox's total rentals in 2012.

⁴⁷ USPS-LR-MC2013-57/NP7.

DVDs,⁴⁸ compared to Netflix's volume of approximately [REDACTED],⁴⁹ which also measures both the outgoing and return trips. In 2013, RedBox rented approximately 17 million video games,⁵⁰ compared to GameFly's volume of [REDACTED],⁵¹ which measures both the outgoing and return trips, and approximately 759 million video DVDs,⁵² compared to Netflix's volume of [REDACTED],⁵³ which also measures both the outgoing and return trips. Excluding competition from streaming, downloading, and other forms of access to digitized entertainment content, and considering only access to digitized entertainment content provided through a physical DVD, the volume comparison above shows that kiosk access serves as a feasible substitute for consumers who access digitized entertainment content through mail delivery. Accordingly, even if the Commission adopts an unduly narrow definition of the relevant market as limited to the rental of physical DVDs, the price of kiosk access to digitized entertainment content will constrain the price of the Round-Trip Mailer product.

III. THE ROUND-TRIP MAILER PRODUCT DOES NOT FALL WITHIN THE PRIVATE EXPRESS STATUTES.

As described in previous Postal Service submissions in this proceeding, despite the Netflix's contentions, the Private Express Statutes do not cover the Round-Trip

⁴⁸ Outerwall 10-K at 26-27.

⁴⁹ USPS-LR-MC2013-57/NP7. Netflix reports its DVD mail volume for 2012 as [REDACTED], suggesting that the actual number of annual rentals for Netflix and GameFly is equal to one half of the volume reported in USPS-LR-MC2013-57/NP7, and that one rental includes both a outgoing and return trip. Netflix Response to ChIR No. 3 at 3, Table 2.

⁵⁰ Outerwall 10-K at 26-27.

⁵¹ USPS-LR-MC2013-57/NP7.

⁵² Outerwall 10-K at 26-27.

⁵³ USPS-LR-MC2013-57/NP7.

Mailer product. Thus, they do not act as a barrier to classification of the Round-Trip Mailer as a competitive product.

A. The Classification of the Round-Trip Mailer Product Can and Should Be Resolved Without Turning This Proceeding Into a Forum on the Private Express Statutes at Large.

In its most recent comments, Netflix attempts to muddy the focus of this proceeding by seizing upon Federal Express Corporation's ("FedEx's") earlier comments about the scope of the Private Express Statutes. Netflix claims that the Commission cannot "sidestep" the "thornier" and "fundamental" issues raised in FedEx's comments if it is to resolve this proceeding.⁵⁴ Much as Netflix would like an excuse to drag out this proceeding even further by introducing the issues discussed by FedEx,⁵⁵ it is entirely unnecessary for the Commission to do so in order to resolve this proceeding.

As noted in the Postal Service's response to FedEx's comments,⁵⁶ the only bearing that FedEx's comments have on this proceeding is whether they would militate for or against the transfer of the Round-Trip Mailer product to the competitive category. FedEx agrees with the Postal Service that the Round-Trip Mailer product is excluded from the Private Express Statutes. Indeed, despite the multitude of flaws in FedEx's analysis, it is notable that FedEx does not gainsay the Postal Service's arguments that the Round-Trip Mailer product is used to carry (1) merchandise, which does not qualify for the Private Express Statutes, and (2) computer programs, which are exempt from the Private Express Statutes. Therefore, regardless of whether one accepts FedEx's or

⁵⁴ Netflix Comments at 10-13.

⁵⁵ *Id.* at 13.

⁵⁶ United States Postal Service Response to Federal Express Corporation Comments ("USPS Response to FedEx Comments"), PRC Docket Nos. C2009-1(R), MC2013-57, & CP2013-75 (Sept. 23, 2013), at 1, 3.

the Postal Service's views of the monopoly, the Round-Trip Mailer does not fall within the scope of the Private Express Statutes.⁵⁷

Thus, the Commission need not expound on the far-reaching policy issues raised by FedEx concerning the vitality or overall scope of the Private Express Statutes in order to resolve the narrow question before it in this proceeding. The Commission is eminently capable of resolving the proper categorization of the Round-Trip Mailer product under either alternative theory for the time being and reserving the larger policy and legal questions that FedEx raises for a more appropriate forum.⁵⁸

B. Netflix Errs in Its Discussion of Other Points Regarding the Application of the Private Express Statutes.

To clarify another point that Netflix seems to have missed, there is no inconsistency between the Postal Service's positions on Section 3642(b)(1) and (2). Netflix claims that the Postal Service focuses on the physical DVD for the Private Express Statutes issue but on the digital content for the market definition issue.⁵⁹ Obviously, this is not the case: the Postal Service has repeatedly pointed out that the

⁵⁷ Netflix tries to parlay FedEx's comments into something threatening to the Postal Service's position as well as its own, but that attempt is unavailing. Netflix Comments at 13 & fn.38. Whatever the (questionable) merit in FedEx's purported distinction between exemptions and suspensions, on the one hand, and "limitations and restrictions" on those exemptions and suspensions, on the other hand, the "computer programs" exemption is plain on its face. It applies to "[c]omputer programs recorded on media suitable for direct input." 39 C.F.R. § 310.1(a)(7)(xi). A DVD is a medium suitable for direct input, and so the computer program recorded on that DVD – such as one that plays a movie or video game – is not a "letter" for purposes of the Private Express Statutes. While FedEx's purported distinction might pose problems for Netflix's argument that other exemptions are inapplicable, the Postal Service has already explained that those other exemptions are irrelevant in light of the clear exemption for computer programs. United States Postal Service Response to Comments (hereinafter "USPS Order 1827 Reply Comments"), PRC Docket Nos. C2009-1(R), MC2013-57, & CP2013-75 (Sept. 23, 2013), at 9. It also bears mention that the "computer programs" exemption belies the Public Representative's belief that "electronic media" are subject to the Private Express Statutes. See PR Comments at 3.

⁵⁸ This should not be taken to suggest that the Commission necessarily has the statutory authority to re-define the meaning of "letters" subject to the monopoly, simply that if the Commission wishes to consider that question, it can use another forum in which to do so.

⁵⁹ Netflix Comments at 10.

digital content on the DVDs is exempt from the Private Express Statutes as “computer programs,” and the DVDs’ status as “merchandise” hinges on the content that gives them market value as well as on their physical form.⁶⁰ However selective Netflix’s reading, the Postal Service’s position in this proceeding is consistent.

As for Netflix’s insistence that the Round-Trip Mailer product is not used to send merchandise,⁶¹ this conclusion only makes sense if one accepts Netflix’s improperly narrow definition of “merchandise.” It is plain that the Private Express Statutes, as expressed through 39 C.F.R. § 310.1, bespeak a dichotomy between “letters” and “merchandise.” The plainest way to understand “merchandise,” in the context of this dichotomy, is as commodities that have market value: items that can be bought or sold, whether or not the particular shipment is part of an actual sale.⁶² A tin of cookies, a box of rubber bands, and a *Star Wars* DVD have intrinsic commercial value in a way that correspondence and advertising flyers do not. That is true regardless of whether the cookies, rubber bands, or DVD are being sent as a gift, rental, or sale. To be sure, these definitions overlap with respect to items that have market value because of their message, such as books, newspapers, and computer programs. Hence, the exclusions

⁶⁰ See USPS Order 1827 Reply Comments at 5-9.

⁶¹ Netflix Comments at 10.

⁶² To the extent that dictionary definitions have the import here to which Netflix would ascribe them, it is notable that Black’s Law Dictionary does not endorse Netflix’s crabbed understanding of “merchandise.” BLACK’S LAW DICT. 1008 (8th ed. 2004) (defining the term not only as “that which is passed from one person to another by purchase and sale,” but also as “[i]n general, a movable object *involved in trade or traffic*; . . . *an article of trading or the class of objects in which trade is carried on by physical transfer*, collectively, mercantile goods, wares or commodities, or any subjects of regular trade, animate as well as inanimate[;] . . . [p]urchase and sale; *trade; traffic, dealing*, or advantage from dealing” (emphasis added)). Clearly, renting – the exchange of goods, on condition of return, for monetary consideration – is a form of trade, traffic, or dealing. See *id.* at 1534 (defining “traffic” as, among other things, “[t]he passing or exchange of goods or commodities from one person to another for an equivalent in goods or money”).

in 39 C.F.R. § 310.1(a)(7) are designed to make explicit that such items qualify as “letters.”

As the Postal Service has already explained, mail classification in general, and the administration of the Private Express Statutes in particular, necessarily turn on the objective features of a mailpiece and its contents; they cannot turn on the nature of third parties’ intercourse, which is abstract and obscure from the mailpiece itself.⁶³ Thus, it matters not how many DVDs Netflix or GameFly purports to “sell,” however they might understand that term.⁶⁴ What matters is that the contents of a Round-Trip Mailer – a movie or video game DVD, including in particular its digital computer program content – have market value in a way that a *bona fide* letter does not, and those contents are therefore merchandise.⁶⁵

IV. MAINTENANCE OF THE ROUND-TRIP MAILER AS A MARKET-DOMINANT PRODUCT WITH AN EQUALIZED RATE WILL DISCOURAGE INNOVATION AND EFFICIENCY IN THE MAILING INDUSTRY.

Netflix identifies numerous competitive concerns created by the Commission’s market-dominant rate equalization remedy and exacerbated by GameFly’s addition of video DVD rental services.⁶⁶ These concerns identify important considerations for the

⁶³ USPS Order 1827 Reply Comments at 5-6.

⁶⁴ Moreover, Netflix has not quantified how many of its “rentals” constitute effective sales, in that the customer retains a rented DVD in exchange for paying its cost. *See id.* at 6.

⁶⁵ With its insistence that the relevant market is that for physical DVD delivery, GameFly appears to implicitly support the position that this proceeding concerns merchandise, not “letters.” *E.g.*, Hodess Declaration at 17. If the Commission were to take this tack instead of focusing on digitized entertainment content, then this would have implications for the market definition analysis under Section 3642(b)(1) as well. As Netflix points out, one would expect FedEx and UPS to be competitors in the physical delivery of DVDs. Netflix Comments at 10. As discussed in section I above, Commission precedent squarely calls for a comprehensive view of the delivery market, not one that is confined to a single segment, much less a single commodity. FedEx and UPS indeed compete with the Postal Service in the delivery of lightweight physical items, be they DVDs or other similar articles. Even in this alternative view, then, the Round-Trip Mailer qualifies for competitive product status.

⁶⁶ Netflix Comments at 8-9.

Commission as it considers these dockets, and they demonstrate that the Commission's decision in these dockets could have far-reaching effects for consumers, mailers, and the Postal Service.

As recognized by Netflix, the market-dominant rate equalization remedy imposed by the Commission in Order No. 1828 will continue to affect competition in the market for digitized entertainment content, and this impact will increase as GameFly engages increases its competition with video DVD letter mailers. Competition encourages innovation and efficiency, which benefits consumers in the form of lower prices, and mailers and the Postal Service in the form of lower costs. As described below, maintenance of a market-dominant Round-Trip Mailer product with an equalized rate will distort competition in the market for consumer access to digitized entertainment content, and has the potential to harm consumers, mailers, and the Postal Service.

The evidence presented in Docket No. C2009-1 reflects a stark contrast in the degree of innovation undertaken by one-ounce DVD letter mailers, including Netflix, and GameFly, which mails its DVDs as two-ounce flats, with respect to the provision of consumer access to digitized entertainment content. Netflix's business model reflects consistent innovation and improvement of the methods of providing access to digitized entertainment content, as Netflix has conducted extensive research and applied modifications to its physical DVDs and mailing practices aimed at providing high-quality, low-cost service to its customers.⁶⁷ This innovation continues today, as Netflix expands

⁶⁷ PRC Docket No. C2009-1, Tr. VII/1297-1303, 1306-1309, 1326, 1332, 1334, 1361-62, 1366-74; Tr. VIII/1537-40, 1545-46, 1550, 1554-55.

its streaming capacity and the compatibility of its DVD mailers with lower-cost, automated letter processing.⁶⁸

Unlike Netflix, GameFly has undertaken more limited efforts at innovation and improvement. In fact, GameFly's CEO testified that he was not aware of the industry standard or composition of DVDs,⁶⁹ knowledge which helped inform many of the innovative changes made by Netflix.

The market-dominant Round-Trip Mailer product with an equalized rate imposed by the Commission will discourage DVD letter mailers from pursuing innovative improvements aimed at making their DVD mailers more compatible with lower-cost automated letter processing. Absent the market-dominant rate equalization remedy imposed by the Commission, more innovative DVD letter mailers would benefit from lower costs, which would enable them to compete more effectively through lower prices to consumers. But the market-dominant rate equalization remedy imposed by the Commission eliminates the incentives for DVD mailers to pursue more innovative, lower-cost mailing practices because the Commission's remedy equalizes the prices for innovative, lower-cost one-ounce DVD letter mailers and DVD mailers that continue to utilize higher-cost flats processing for heavier two-ounce mail pieces.

The Commission's distortion of competition through establishment of the market-dominant Round-Trip Mailer product with an equalized rate has the potential to harm consumers, mailers, and the Postal Service. Where GameFly competes directly with

⁶⁸ See Netflix 10-K at 1. Although some incoming Netflix DVD mail received manual culling, all outbound Netflix DVD mail received automated letter processing. However, "Netflix has never maintained that it expects to receive manual culling for any future DVD mail entered as generic First-Class Mail." Netflix Comments at 4 (internal quotation marks and citation omitted).

⁶⁹ PRC Docket No. C2009-1, Tr. V/892.

DVD letter mailers for video rentals delivered through the mail, the equalization of the one-ounce DVD letter rate and the two-ounce DVD flat rate eliminates the competitive benefits achieved by DVD letter mailers through lower mailing costs and the ability to charge lower prices to consumers. This distorts competition, as the Commission subsidizes less efficient mailers that utilize heavier mail pieces and higher-cost mail processing, and consumers do not receive the benefit of lower prices from the most efficient competitors.

Maintenance of the equalized-rate Round-Trip Mailer product within the market-dominant classification has the potential to harm mailers, the Postal Service, and the mailing industry. As incentives for utilization of lower-cost, more efficient mailing practices are eliminated, it is likely that mailers will devote fewer resources toward the improvement of mailing practices, and will utilize heavier mail pieces and higher-cost mail processing methods. As the volume distribution among DVD mail shifts from lower-cost letters to higher-cost flats, recovery of the increased costs associated with the Round-Trip Mailer product would require an increase in the equalized rate. But because the Round-Trip Mailer is a market-dominant product, the rate cap limits the Postal Service's ability to increase the price of the product to cover its costs. Thus, it is possible that revenue collected from non-DVD mailers might be used to subsidize the loss incurred from the market-dominant Round-Trip Mailer product.

Although the rate equalization feature of the Round-Trip Mailer product established by the Commission has a significant role in discouraging innovation and efficiency in the mailing industry, maintenance of this product within the market-

dominant classification restricts the Postal Service's ability to limit the impact of the negative effects described above.

Respectfully submitted,

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